Our Telecommunications segment offers a broad range of voice and data products and services to residential, small office/home office ("SOHO") and small-medium sized enterprises ("SME"), and commercial customers through a network of MLM agents, commercial agents, affinity groups and outbound telemarketing. Our customers are serviced through direct sales and support teams who offer fully managed and fully integrated voice and data solutions.

We have capitalized upon a unique synthesis of marketing and network capabilities. Through the strength of our agent network we are adding new customers each month, many of them with a strong international usage component. Due to our favorable cost structure and network optimization, we offer competitive rates to selected international regions. We continue to experience customer attrition particularly with our 10-10-XXX customer base which we have not marketed directly since 2002. We have also seen the average revenue per user ("ARPU") decline. The Company's domestic telephone network continues to operate at well below available capacity leading to cost inefficiencies. We attribute this to increased cellular penetration and deregulation in various countries which have lower rates per month in those markets. This is most evident in India in 2004. Additionally, regulatory uncertainty exists in the domestic telephone markets due to recent court decisions. Future regulatory changes may penalize or benefit the current operations of the business.

We differentiate ourselves to our residential customers by offering attractively priced bundles of international minutes, both on a stand alone basis and as part of a local dial tone + long-distance package to preferred destinations, and by specialized customer service, which includes in-language customer support. By using this targeted strategy, we have acquired a substantial number of ethnic users whose monthly spending on telecommunications services is generally higher than that of the average retail customer. These subscribers also tend to exhibit higher brand loyalty, resulting in lower customer turnover ("churn") than average retail consumers for our type of products.

Our proprietary technology enables us to offer unbundled value-added services such as voicemail, unified messaging and on-the-fly conferencing at a low cost, creating another competitive advantage when targeting retail customers. These features distinguish us from mass-market providers that typically offer higher priced, "one-size-fits-all" national and international rate plans.

Our direct sales force focuses on multi-location customers with limited information technology ("IT") resources. By taking a consultative approach to network solutions and providing in-depth analysis of our customers' business needs and operating environments, we are able to design and deliver competitively priced and customized voice and data solutions. Our commercial customers also benefit from our relationships with multiple providers, which ensures superior service with respect to network redundancy, cost and supplier risk. We are able to offer strong customer service due to easy access to information and to our engineering, technical and administrative staffs.

Our voice network features 11 voice switches and nationwide Feature Group D ("FGD") access, which enables low cost call origination. Our data network consists of 17 Nortel Passports that have recently been upgraded to support multi-protocol label switching ("MPLS"). Finally, we have relationships with multiple tier I and tier II providers in the U.S. and abroad, which allows for efficient call management and least cost routing.

Technologies:

In 1994, we began operating as an Internet service provider and quickly identified that the emerging IP environment was a promising basis for enhanced service delivery. We soon turned to designing and building an IP telecommunications platform consisting of our proprietary software, hardware and leased telecommunications lines. The goal was to create a platform with the quality and reliability necessary for voice transmission.

In 1997, we started offering enhanced services over a mixed IP-and-circuit-switched network platform. These services offered a blend of traditional and enhanced communication services and combined the inherent cost advantages of the IP-based network with the reliability of the existing Public Switched Telephone Network ("PSTN").

In August 1997, we acquired MiBridge, Inc. ("MiBridge"), a communications technology company engaged in the design, development, integration and marketing of a range of software telecommunications products that support multimedia communications over the PSTN, LANs and IP networks. The acquisition of MiBridge permitted us to accelerate the development and deployment of IP technology across our network platform.

In 1998, we first deployed our real-time IP communications network platform. With this new platform, all core operating functions such as switching, routing and media control became software-driven. This new platform represented the first nationwide, commercially viable VoIP platform of its kind. Following the launch of our software-defined VoIP platform in 1998, we continued to refine and enhance the platform to make it even more efficient and capable for our partners and customers.

On December 6, 2002, we entered into a definitive purchase and sale agreement to sell substantially all of the assets and customer base of our wholly owned subsidiary I-Link Communications, Inc. ("ILC") to Buyers United, Inc. ("BUI"), which closed on May 1, 2003. The sale included the physical assets required to operate our nationwide network using our patented VoIP technology (constituting the core business of the ILC business) and a fully paid non-exclusive perpetual license to our proprietary software-based network convergence solution for voice and data. The sale of the ILC business removed essentially all operations that did not pertain to our proprietary software-based convergence solution for voice and data. This sale marked the final stage of the transformation of our Technologies operations into a business based principally on the licensing of our proprietary software.

Today, our Technologies segment offers a proven network convergence solution for the deployment of IP-based voice and data services over a single network. We have over nine years of experience developing VoIP technologies. Our proprietary soft-switch solution enables existing telecom service providers to reduce telecommunications costs and permits new communications service providers to enter the enhanced communications market with limited capital investment. In addition, we own four patents and utilize the technology supported by those patents in providing our proprietary software solutions. We believe that we hold foundational patents for VoIP in our VoIP Patents. To date, we have licensed portions of that technology to third parties on a non-exclusive basis. In addition, we also have several patent applications pending before the Untied States Patent and Trademark Office and other such authorities internationally. We are pursuing opportunities to leverage our patents through a focused licensing strategy that targets carriers, equipment vendors and customers who are deploying IP for phone-to-phone communication.

Business Strategy

Our business strategy is to build a large, profitable base of residential, SME and corporate accounts that purchase bundled telecom services. As part of our strategy, we have consolidated our high quality communications networks and are in the process of restructuring our operations in order to leverage our infrastructure across branded sales channels.

To achieve our goals, through both organic and acquisition growth we plan to:

Penetrate our distribution channels: Our distribution channels, which we have built over the last three years, continue to grow and mature. Our recently launched Platinum Agent Program rewards agents for substantial and persistent production. The equity incentives available under this program are expected to increase both the number of commercial agents and the revenue contribution per commercial agent. The program provides for stock purchase warrants accruing for the benefit of selected agents, resulting in recurring revenue for us and providing incentives for our agents so that their objectives and ours are aligned.

Expand our product portfolio: We have recently expanded our product set to include local dial tone in order to extend the average life and monthly average revenues of current and future customers. We are currently delivering local dial tone services to customers via the UNE-P. In addition, we intend to roll-out VoIP and related services to our residential, SME and enterprise customers beginning in the later part of 2004 and continuing into 2005. Products will include an IP origination service with enhanced features such as call screening and find me/follow me, and multimedia business services that integrate voice, video and text in a single communication session.

Enter new geographic markets: In first quarter of 2004, we launched our local + long-distance bundled product set in New York and New Jersey. In the second quarter of 2004, we entered the Pennsylvania, Massachusetts and Florida markets. We currently offer stand alone long-distance services nationwide in the US.

License our intellectual property: We have four issued patents and two pending patent applications, which we utilize to provide our proprietary solutions. We believe that we hold the foundational patents for the manner in which a significant portion of VoIP traffic is routed in the marketplace today. We have licensed portions of our technology to third parties on a non-exclusive basis. We plan to further monetize our intellectual property by offering licenses to service providers, equipment companies and end-users who are deploying VoIP networks for phone-to-phone communications.

Leverage our existing scalable infrastructure: We have created a network and back office infrastructure that satisfies the needs of our existing customers and that will support additional revenue growth without significant incremental capital investment. We continue to reduce our network costs and are completing the consolidation of duplicate back office functions. Our IT strategy is expected to ensure efficiency and integrity internally by eliminating redundant costs and mitigating strategic risks. We expect to make significant incremental capital investments pursuant to our expanded product portfolio outlined above, in addition to the base level of annual capital investment necessary to keep our infrastructure efficient and maintained.

Industry

Historically, the communications services industry has transmitted voice and data over separate networks using different technologies. Traditional carriers have typically built telephone networks based on circuit switching technology, which establishes and maintains a dedicated path for each telephone call until the call is terminated.

The communications services industry continues to evolve, both domestically and internationally, providing significant opportunities and risks to the participants in these markets. Factors that have been driving this change include:

- entry of new competitors and investment of substantial capital in existing and new services resulting in significant price competition
- technological advances resulting in a proliferation of new services and products and rapid increases in network capacity
- the Telecommunications Act of 1996 (the "1996 Act")
- growing deregulation of communications services markets in the United States and in selected countries around the world

VoIP is a technology that can replace services provided by the traditional telephone network. This type of data network is more efficient than a dedicated circuit network because the data network is not restricted by the one-call, one-line limitation of a traditional telephone network. This improved efficiency creates cost savings that can be either passed on to the consumer in the form of lower rates or retained by the VoIP provider.

The VoIP industry has grown dramatically from the early days of calls made through personal computers. According to a research study from Insight Research Corporation, VoIP-based services is projected to grow significantly through 2007, representing a growth opportunity for VoIP service providers.

Competition

Competition in the telecommunications industry is based upon pricing, customer service, billing services and perceived quality. We compete against numerous telecommunications companies that offer essentially the same services as we do. Many of our competitors, including the incumbent local exchange carriers ("ILECs"), are substantially larger and have greater financial, technical and marketing resources. Our success will depend upon our continued ability to provide high quality, high value services at prices competitive with, or lower than, those charged by our competitors.

The ILECs and the major carriers, including SBC, Verizon, BellSouth, AT&T, Sprint Corporation and MCI/Worldcom, Inc., have targeted price plans at residential and small business customers — our primary target market — with significantly simplified rate structures and with bundles of local services with long-distance, which may lower overall local and long-distance prices. Competition is also fierce for the commercial customers that we serve. This market was typically dominated by AT&T, Sprint and MCI (national long-distance carriers) but now offers additional growth opportunities for the incumbent local exchange companies as they are able to service multi-location customers with offices located outside of their local calling area.

Pricing pressure has existed for several years in the telecommunications industry and is expected to continue, and this is coupled with the introduction of new technologies, such as VoIP, which seek to provide voice communications at a cost below that of traditional circuit-switched service. In addition, wireless carriers have marketed their services as an alternative to traditional long-distance and local services, further increasing competition and consumer choice. Reductions in prices charged by competitors may have a material adverse effect on us. Cable companies have entered the telecommunications business, and this development may increase the competition faced by the Company.

The ILECs are well-capitalized, well-known companies that have the capacity to "bundle" other services, such as local and wireless telephone services and high speed Internet access, with long- distance telephone services. The ILECs' name recognition in their existing markets, the established relationships that they have with their existing local service customers, their ability to take advantage of those relationships, and the possibility that interpretations of the 1996 Act may be favorable to the ILECs, also make it more difficult for us to compete with them.

Government Regulation

Telecommunications industry

The telecommunications industry is subject to government regulation at federal, state and local levels. Any change in current government regulation regarding telecommunications pricing, system access, consumer protection or other relevant legislation could have a material impact on our results of operations. Most of our current operations are subject to regulation by the Federal Communications Commission ("FCC") under the Communications Act of 1934. In addition, certain of our operations are subject to regulation by state public utility or public service commissions. Changes in the regulation of, or the enactment of changes in interpretation of, legislation affecting us could damage our operations and lower the price of our common stock.

The 1996 Act, among other things, allows the Regional Bell Operating Companies ("RBOC") and others to enter the long-distance business. Entry of the RBOCs or other entities, such as electric utilities and cable television companies, into the long-distance business may have a negative impact on our business or our customers. We anticipate that some of these entrants will prove to be strong competitors because they are better capitalized, already have substantial customer bases, and enjoy cost advantages relating to local telecom lines and access charges. This could adversely impact the results of our operations, which could have a negative effect on the price of our common stock. In addition, the 1996 Act provides that state proceedings may in certain instances determine access charges we are required to pay to the local exchange carriers. If these proceedings occur, rates could increase which could lead to a loss of customers, weaker operating results and the lowering of the price of our common stock.

Overview of Federal Regulation

As a carrier offering telecommunications services to the public, we are subject to the provisions of the Communications Act of 1934, as amended, and FCC regulations issued thereunder. These regulations require us, among other things, to offer our regulated services to the public on a non-discriminatory basis at just and reasonable rates. We are subject to FCC requirements that we obtain prior FCC approval for transactions that would cause a transfer of control of one or more regulated subsidiaries. Such approval requirements may delay, prevent or deter transactions that could result in a transfer of control of our company.

International Service Regulation. We possess authority from the FCC, granted pursuant to Section 214 of the Communications Act of 1934, to provide international telecommunications service. The FCC has streamlined regulation of competitive international services and has removed certain restrictions against providing certain services. Presently, the FCC is considering a number of international service issues that may further alter the regulatory regime applicable to us. For instance, the FCC is considering revisions to the rules regarding the rates that international carriers like us pay for termination of calls to mobile phones located abroad.

Pursuant to FCC rules, we have cancelled our international and domestic FCC tariffs and replaced them with a general service agreement and price lists. As required by FCC rules, we have posted these materials on our Internet web site. The "detariffing" of our services has given us greater pricing flexibility for our services, but we are not entitled to the legal protection provided by the "filed rate doctrine," which generally provides protections to carriers from legal actions by customers that challenge the terms and conditions of service.

Interstate Service Regulation. As an inter-exchange carrier ("IXC"), our interstate telecommunications services are regulated by the FCC. While we are not required to obtain FCC approval to begin or expand our interstate operations, we are required to obtain FCC approvals for certain transactions that would affect our ownership or the services we provide. Additionally, we must file various reports and pay certain fees and assessments. We are subject to the FCC's complaint jurisdiction and must contribute to the federal Universal Service Fund ("USF"). We must also comply with the Communications Assistance for Law Enforcement Act ("CALEA"), and certain FCC regulations which require telecommunications common carriers to modify their networks to allow law enforcement authorities to perform electronic surveillance.

Overview of State Regulation

Through certain of our subsidiaries, we are authorized to provide intrastate interexchange telecommunications services and, in certain states, are authorized to provide competitive local exchange services by virtue of certificates granted by state public service commissions. Our regulated subsidiaries must comply with state laws applicable to all similarly certified carriers including the regulation of services, payment of regulatory fees and preparation and submission of reports. The adoption of new regulations or changes to existing regulations may adversely affect our ability to provide telecommunications services. Consumers may file complaints against us at the public service commissions. The certificates of authority we hold can be generally conditioned, modified, cancelled, terminated or revoked by state public service commissions. Further, many states require prior approval or notification for certain stock or asset transactions, or in some states, for the issuance of securities, debts, guarantees or other financial transactions. Such approvals can delay or prevent certain transactions.

Overview of Ongoing Policy Issues

Local Service. Through the 1996 Act, Congress sought to establish a competitive and deregulated national policy framework for advanced telecommunications and information technologies. To date, local exchange competition has not progressed to a point where significant regulatory intervention is no longer required. Regulators believed that a "hands-off" policy would drive local exchange service into an adequately competitive market, but there continues to be a strong need for policy issue clarification and construction. Some policy changes have been addressed through the court system, not the regulatory system. For instance, the FCC has attempted several times to develop a list of UNEs which are portions of the ILEC networks and services that must be sold separately to competitors. On several occasions, the courts have rejected the FCC's approach to defining UNEs. The FCC's most recent attempt to develop rules, the Triennial Review Order, was vacated by the U.S. Circuit Court of Appeals in Washington D.C. on March 4, 2004. The Court's ruling went into effect on June 16, 2004. Since then, several competitive carriers have filed appeals with the U.S. Supreme Court, seeking a stay and review of the U.S. Circuit Court's ruling. Those requests for appeal are still pending. At the same time, the FCC is expected to issue interim rules regarding access to, and pricing of, UNEs that will be in effect until permanent rules are issued by the FCC. However, if the U.S. Supreme Court agrees to review the decision of the U.S. Circuit Court and issues a stay of that lower court's decision, then the effective date of the U.S. Circuit Court's ruling and the effectiveness of the FCC's interim rules could be substantially delayed. We are unable to determine the outcome of these proceedings; however, the inability to purchase UNEs or price increase related to the interim rules could increase our costs for providing local service, or prevent us from providing the service altogether.

Universal Service Fund. In 1997, the FCC issued an order implementing Section 254 of the 1996 Act, regarding the preservation of universal telephone service. Section 254 and related regulations require all interstate and certain international telecommunications carriers to contribute toward the USF, a fund that provides subsidies for the provision of service to schools and libraries, rural health care providers, low income consumers and consumers in high cost areas.

Quarterly, the Universal Service Administrative Company ("USAC"), which oversees the USF, reviews the need for program funding and determines the applicable USF contribution percentage that interstate telecommunications carriers must contribute. While carriers are permitted to pass through the USF charges to consumers, the FCC has strictly limited amounts passed through to consumers in excess of a carrier's determined contribution percentage.

As discussed below, the industry is moving from traditional circuit-switched telephone service to digitized IP-based communications. It is possible that this trend could threaten the amount of revenues USAC can collect through the USF system, and that the resulting revenue shortfall could prevent the system from meeting its funding demands. Separately from the FCC's inquiry into the regulation of IP-based voice service, the FCC could exercise its so called "permissive authority" under the 1996 Act and assess USF contribution on VoIP providers. To date, only some VoIP providers contribute to the USF. If VoIP providers were exempted from USF contributions, telecommunications carriers would likely pay significantly higher USF contributions; conversely, if VoIP providers were required to contribute, traditional telecommunications carriers would contribute less. In addition to the FCC, Congress is considering this issue. Current Congressional debates are divided over whether IP-based telephony service providers should be required to contribute to the USF. A decision to require VoIP providers to contribute to the USF may adversely affect our provision of VoIP services.

VoIP Notice of Proposed Rule Making. In March 2004, the FCC issued the VoIP Notice of Proposed Rulemaking to solicit comments on many aspects of the regulatory treatment of VoIP services (the "VoIP NPRM"). The FCC continues to consider the possibility of regulating access to IP-based services, but has not yet decided on the appropriate level of regulatory intervention for IP-based service applications. Should the FCC rule that our software-based solution for VoIP deployment, and other similar service applications should be regulated, our VoIP services may be adversely affected.

Further, the VoIP NPRM will likely address the applicability of access charges to VoIP services. Access charges provide compensation to local exchange carriers for traffic that originates or terminates on their networks. Certain LECs have argued that certain types of VoIP carriers provide the same basic functionality as traditional telephone service carriers, in that they carry a customer's call from an origination point to a termination destination. Any ruling or decision from the FCC requiring VoIP carriers to pay access charges to ILECs for local loop use may adversely affect our VoIP services.

The VoIP NPRM is also expected to address the extent to which CALEA will be applicable to VoIP services. Recently, in a separate proceeding, the Federal Bureau of Investigation and other federal agencies have asked the FCC to clarify that VoIP is a telecommunications service, for the purpose of subjecting VoIP to CALEA's wiretapping requirements.

Broadband Deployment. Broadband refers to any platform capable of providing high bandwidth-intensive content and advanced telecommunications capability. The FCC's stated goal for broadband services is to establish regulatory policies that promote competition, innovation and investment in broadband services and facilities. Broadband technologies encompass evolving high-speed digital technologies that offer integrated access to voice, high-speed data, video-on-demand or interactive delivery services. The FCC is seeking to 1) encourage the ubiquitous availability of broadband access to the Internet, 2) promote competition across different platforms for broadband services, 3) ensure that broadband services exist in a minimal regulatory environment that promotes investment and innovation and 4) develop an analytical framework that is consistent, to the extent possible, across multiple platforms. The FCC has opened several inquiries to determine how to promote the availability of advanced telecommunications capability with the goal of removing barriers to deployment, encouraging competition and promoting broadband infrastructure investment. For instance, the FCC is considering the appropriate regulatory requirements for ILEC provision of domestic broadband telecommunications services. The FCC's concern is whether the application of traditional common carrier regulations to ILEC-provided broadband telecommunications services is appropriate. Under existing regulations, ILECs are treated as dominant carriers absent a specific finding to the contrary for a particular market and, as dominant carriers, are subject to numerous regulations, such as tariff filing and pricing requirements.

On February 7, 2002, the FCC released its third biennial report on the availability of broadband, in which it concluded that broadband is being deployed in a reasonable and timely manner. The report showed that the advanced telecommunications services market continues to grow and that the availability of and subscribership to high-speed services increased significantly since the last report. Additionally, the report noted that investment in infrastructure for advanced telecommunications remains strong. The data in the report is gathered largely from standardized information from providers of advanced telecommunications capability including wireline telephone companies, cable providers, wireless providers, satellite providers, and any other facilities-based providers of 250 or more high-speed service lines (or wireless channels) in a given state.

Internet Service Regulation. The demand for high-speed Internet access has increased significantly over the past several years as consumers increase their Internet use. The FCC is active in reviewing the need for regulatory oversight of Internet services and to date has advocated less regulation and more market-based competition for broadband providers. The FCC's stated policy is to promote the continued development of the Internet and other interactive computer-based communications services. We cannot be certain that the FCC will continue to take a deregulatory approach to the Internet. Should the FCC increase regulatory oversight of Internet services, our costs could increase for providing those services.

Recent legislation in the United States (including the Sarbanes-Oxley Act of 2002) is increasing the scope and cost of work provided to us by our independent auditors and legal advisors. Many guidelines have not yet been finalized and there is a risk that we will incur significant costs in the future to comply with legislative requirements or rules, pronouncements and guidelines by regulatory bodies, including the cost of restating previously reported financial results, thereby reducing profitability.

Critical Accounting Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to intangible assets, contingencies, collectibility of receivables and litigation. Management bases its estimates and judgments on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The critical accounting estimates used in the preparation of our consolidated financial statements are discussed in our Annual Report on Form 10-K for the year ended December 31, 2003. To aid in the understanding of our financial reporting, a summary of significant accounting policies are described in Note 3 of Consolidated Financial Statements and Notes thereto included in Item 1 of this report. These policies have the potential to have a more significant impact on our financial statements, either because of the significance of the financial statement item to which they relate, or because they require judgment and estimation due to the uncertainty involved in measuring, at a specific point in time, events which are continuous in nature.

Liquidity and Capital Resources

The Company has incurred substantial operating losses and negative cash flows from operations since inception. At June 30, 2004 the Company had a stockholders' deficit of $51,672 ($42,953 – December 31, 2003), negative working capital of $20,413 ($26,576 – December 31, 2003), amounts due to its controlling shareholder of $42,122 ($28,717 – December 31, 2003) and $7,154 ($12,127 – December 31, 2003) owing under its revolving credit facility (included in working capital). There are $nil additional borrowings available under the revolving credit facility at June 30, 2004.

The related party debt is owed to the Company's controlling shareholder, Counsel Corporation (collectively with all its subsidiaries "Counsel") and is due at December 31, 2005, subject to certain contingent acceleration clauses linked to the raising of capital. In addition to the Company's expectation of raising funds in the remainder of 2004 from third parties, the Company has a funding commitment from Counsel to fund, through long-term intercompany advances or equity contributions, all capital investment, working capital or other operational cash requirements (the "Keep Well") through June 30, 2005. During the first six months of 2004, Counsel advanced the Company $9,439 under the Keep Well, and converted $1,929 of accrued interest into principal.

The revolving credit facility is provided by an asset based lender. The asset based lender is secured by a first lien on all of the assets of ACC. Borrowings under the facility are based on various advance rates of the accounts receivable base subject to certain reductions and covenants. Amounts available under the asset based facility are subject to change based upon the level of receivables and other related factors, such as the aging of accounts, customer concentrations, etc. Borrowings under this facility are classified as a current liability due to the demand nature of the borrowings. The facility matures on June 30, 2005. The Company is looking to extend the term of the facility beyond its current maturity date, or to replace the facility prior to maturity.

In August 2004, the Company implemented a resizing of the organization targeted at reducing its operating costs. The cost cutting reflects both the continued efficiencies created by the ongoing integration of the Company's operations, related to its four acquisitions over the last three years, and management's commitment to its objective of achieving break-even operating income by the end of 2004, despite softening revenue and regulatory uncertainty. Approximately 20 percent of the Company's work force has been removed from the organization. The reduction affected staff in the San Diego, Pittsburgh and Somerset facilities. The Company anticipates that it will record expenses of between $1,000 and $2,000 during the third quarter ended September 30, 2004 related to this restructuring. Restructuring charges will include employee reduction costs and lease termination costs and may include additional charges related to potential asset impairments.

The Company does not expect to generate net cash flow from operating activities in the remainder of 2004. The Company expects that funding to support its operations will be derived from proceeds from a third party fund raise which may take the form of debt, equity or a hybrid instrument, or from the proceeds on the sale of assets in addition to advances under the Keep Well. In the first half of 2004, the Company was funded primarily by increases in related party debt and from the proceeds on the sale of the shares held in BUI.

Management intends to raise funds from third parties to support the operating needs of the business. Use of funds from such arrangements may include such uses as funding operations, improving working capital, repaying obligations of the business and funding future merger and acquisition activities. There can be no assurance that the Company's capital raising efforts will be successful or can occur on favorable terms to existing security or debt holders.

There continues to be no assurance that the Company will be able to improve its cash flow from operations, obtain additional third party financing, extend, repay or refinance its debt with Counsel or its asset based lender on favorable terms, or obtain an extension of the existing funding commitment from Counsel or its asset based lender beyond their respective maturity dates. This circumstance raises substantial doubt about the Company's ability to continue as a going concern. The accompanying condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability of assets and liquidation of liabilities that may result from this uncertainty.

Cash Position

Cash and cash equivalents as of June 30, 2004 were $2,357 compared to $2,033 at December 31, 2003.

Cash flows from operating activities

Our working capital deficit decreased to $20,413 as of June 30, 2004, from $26,576 as of December 31, 2003. The decrease in our working capital deficit is primarily related to the decrease in our revolving credit facility of $4,973 due to payments made to our asset based lender during the first half of the year, the decrease in our unearned revenue of $4,182 since December 31, 2003 due principally to the recognition of revenue as cash receipts associated with our non-recurring network service offering became unencumbered, and a reduction in our accounts payable and accrued expenses of $1,021. This was partially offset by a decrease in our accounts receivable of $3,666 during the first half of 2004.

Cash used by operating activities during the six months ended June 30, 2004 was $4,852 as compared to $5,085 during the same period in 2003. The net decrease in cash used in 2004 was primarily due to an $11,176 decrease in net loss to $9,423 for the first six months of 2004 from a net loss of $20,599 for the same period in 2003.

Cash flows from investing activities

Net cash provided by investing activities during the six months ended June 30, 2004 was $3,189 as compared to net cash used of $1,145 for the same period in 2003. In the first half of 2004, net cash provided by investing activities relates to $3,582 in proceeds received from the sale of common stock in BUI received as consideration for the sale of the ILC operations in May 2003, offset by the purchase of equipment in the amount of $393.

Cash flows from financing activities

Financing activities provided net cash of $1,987 during the six months ended June 30, 2004 as compared to $4,658 for the same period in 2003. The decrease from 2003 to 2004 is due primarily to repayment of $4,973 on our revolving credit facility during the first half of 2004, as opposed to receipt of $5,762 during the same period in 2003, repayment of a note payable of $1,104 in the second quarter of 2004 as final settlement of the acquisition of certain assets of the former assets of RSL, scheduled lease and note payable payments of $1,390, offset by the receipt of $9,439 in funding from Counsel in the first half of 2004, compared to receiving $100 from Counsel during the same period in 2003.

Supplemental Statistical and Financial Data

The following data is provided for additional information about our operations. It should be read in conjunction with the quarterly segment analysis provided herein. All amounts below are unaudited.

	2003				2004	
(In millions of dollars, except where indicated)	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Gross revenues — product mix						
Domestic long-distance	$ 7.8	$ 7.8	$ 7.4	$ 7.5	$ 6.4	$
International long-distance	12.8	14.4	15.3	15.1	13.0	
Local dial tone	—	—	—	—	0.1	
MRC/USF[1]	2.3	2.4	2.8	3.0	3.0	
Dedicated voice	0.4	0.3	0.4	0.4	0.3	
Direct sales revenues	7.1	6.8	5.9	5.9	5.4	
Other	—	0.1	0.2	—	0.1	
Total telecommunications revenue	**$ 30.4**	**$ 31.8**	**$ 32.0**	**$ 31.9**	**$ 28.3**	**$:**
Network service offering	—	4.1	3.1	0.4	6.4	
Technology licensing and development	—	1.1	1.0	0.1	0.5	
Total revenues	**$ 30.4**	**$ 37.0**	**$ 36.1**	**$ 32.4**	**$ 35.2**	**$:**
Gross revenues — product mix (minutes)						
Domestic long-distance [5]	135,236,248	140,798,912	134,198,098	121,880,023	129,277,406	134,649,
International long-distance	83,191,655	93,896,850	98,873,877	98,978,290	91,288,985	83,923,
Dedicated voice	9,571,155	7,772,277	9,364,583	8,653,038	9,653,915	9,374,
Active Retail Subscribers (in number of people):						
Dial- around [2]						
Beginning of Period	199,375	228,330	215,187	206,937	192,678	164,
Adds	112,223	85,246	100,624	63,349	46,518	40,
Churn	(83,268)	(98,389)	(108,874)	(77,608)	(74,865)	(65,
End of Period	228,330	215,187	206,937	192,678	164,331	138,
Local dial tone						
Beginning of Period	—	—	—	—	—	2,
Adds	—	—	—	—	3,112	10,
Churn	—	—	—	—	(217)	(2,
End of Period	—	—	—	—	2,895	11,
1+[3]						
Beginning of Period	72,008	136,896	174,486	168,242	161,570	165,
Adds	109,646	81,040	43,964	25,356	25,344	27,
Churn	(44,758)	(43,450)	(50,208)	(32,028)	(21,067)	(20,
End of Period	136,896	174,486	168,242	161,570	165,847	172,
Total subscribers (End of Period)	**365,226**	**389,673**	**375,179**	**354,248**	**333,073**	**322,**
Direct Sales[6]						
Active Customer Base	276	254	236	227	256	
Total top 10 billing	$ 1,243	$ 1,163	$ 1,094	$ 1,050	$ 926	$ 1,
Avg monthly revenue per user (active subscriptions) in absolute						

dollars:[4]						
Dial- around	$ 21.61	$ 20.60	$ 22.07	$ 23.01	$ 20.89	$ 2
Local dial tone	$ —	$ —	$ —	$ —	$ 11.51	$ 2:
1+	$ 20.70	$ 22.16	$ 24.17	$ 26.20	$ 24.92	$ 2
Telecommunications revenue by customer type:						
Dial- around	$ 14.8	$ 13.3	$ 13.7	$ 13.3	$ 10.3	$
1+	8.5	11.6	12.2	12.7	12.4	
Local dial tone	—	—	—	—	0.1	
Direct sales	7.1	6.8	5.9	5.9	5.4	
Other	—	0.1	0.2	—	0.1	
Total telecommunications revenues	**$ 30.4**	**$ 31.8**	**$ 32.0**	**$ 31.9**	**$ 28.3**	**$:**

(continued on following page)

(In millions of dollars, except where indicated)	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2
Gross revenue — product mix (%):						
Domestic long-distance	25.6%	24.6%	23.1%	23.5%	22.6%	21.4%
International long-distance	42.1%	45.3%	47.8%	47.3%	45.9%	43.1%
Local dial tone	—	—	—	—	0.4%	3.8%
MRC/USF[1]	7.6%	7.5%	8.8%	9.4%	10.6%	10.3%
Dedicated voice	1.3%	0.9%	1.3%	1.3%	1.0%	1.1%
Direct sales revenues	23.4%	21.4%	18.4%	18.5%	19.1%	19.5%
Other	—	0.3%	0.6%	0.0%	0.4%	0.8%
Total telecommunications revenues	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

1 MRC/USF represents "Monthly Recurring Charges" and "Universal Service Fund" fees charged to the customers.

2 "Dial- around" refers to a product which allows a customer to make a call from any phone by dialing a 10-10-XXX prefix.

3 " 1 +" refers to a product which allows a retail customer to directly make a long- distance call from their own phone by dialing " 1" plus the destination number.

4 Average monthly revenues per user is calculated as the revenues of the quarter divided by the number of users at the end divided by 3 to get per month.

5 Includes Local Product Line Bulk/Package Rate Domestic Minutes

6 Represents Number of Parent Customers with Revenues greater than $0 in each calendar month.

Management Discussion of Operations

The following table displays the Company's consolidated quarterly results of operations for the eight quarters ended June 30, 2004.

	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	Q1
		(as restated)	(as restated)	(as restated)	(as restated)	(as restated)	(as resta
Revenues:							
Telecommunications (excluding network service offering shown below)	$19,835	$ 21,622	$ 30,367	$31,853	$31,923	$31,994	$28,36
Network service offering	—	—	—	4,142	3,079	408	6,36
Technologies	321	47	—	1,050	1,049	64	45
Total	20,156	21,669	30,367	37,045	36,051	32,466	35,17
Operating costs and expenses:							
Telecommunication network expense (exclusive of depreciation							

shown below)	11,197	12,235	19,543	19,154	19,266	18,936	16,63
Network service offering	—	1,995	6,205	2,165	807	(70)	-
Selling, general, administrative and other	7,389	9,779	14,225	14,617	13,981	14,441	14,76
Provision for doubtful accounts	1,119	2,274	1,175	1,131	1,466	1,666	1,22
Research and development	317	234	—	—	—	—	-
Depreciation and amortization	985	1,245	1,826	1,758	1,993	1,548	1,70
Total operating costs and expenses	21,007	27,762	42,974	38,825	37,513	36,521	34,32
Operating income (loss)	(851)	(6,093)	(12,607)	(1,780)	(1,462)	(4,055)	84
Other income (expense):							
Interest expense	(1,777)	(2,184)	(2,915)	(3,394)	(3,398)	(3,562)	(3,53
Interest and other income	152	224	2	1	53	1,160	1,37
Total other income (expense)	(1,625)	(1,960)	(2,913)	(3,393)	(3,345)	(2,402)	(2,15
Income (loss) from continuing operations	(2,476)	(8,053)	(15,520)	(5,173)	(4,807)	(6,457)	(1,31
Gain (loss) from discontinued operations, net of $0 tax	(1,463)	(3,365)	(277)	371	213	222	10
Net income (loss)	$ (3,939)	$(11,418)	$(15,797)	$ (4,802)	$ (4,594)	$ (6,235)	$ (1,20

Three-Month Period Ended June 30, 2004 Compared to Three-Month Period Ended June 30, 2003

In order to more fully understand the comparison of the results of continuing operations for the three months ended June 30, 2004 as compared to the same period in 2003, it is important to note the following significant changes in our operations that occurred:

- In July 2003, we completed the acquisition of Transpoint. The operations of Transpoint have been included in the statement of operations for the second quarter of 2004. However, there were no such operations in the second quarter of 2003.
- In November 2002, we began to sell a network service offering obtained from a new supplier. The sale of that product ceased in late July 2003. Revenue from this offering is recognized using the unencumbered cash method. In the second quarter of 2004, $190 was recognized in income compared to $4,142 in the same quarter of 2003. Expenses associated with this offering were recorded when incurred. In the second quarter of 2004 the Company recorded a recovery of $203 in telecommunications network costs compared to incurring a cost of $2,165 during the same period in 2003. The cessation of this product offering does not qualify as discontinued operations under generally accepted accounting principles.
- In January 2004, the Company commenced offering local dial tone services via the UNE-P. By June 30, 2004 services were being offered in five states and the Company had approximately 11,000 local customers on the service. In the second half of the year the Company expects to expand this service into additional states.

Revenues

Telecommunications services revenue decreased $5,624 to $26,229 in the second quarter of 2004 as compared to $31,853 during the same period in 2003 (excluding revenues from our network service offering of $190 and $4,142, respectively). The primary reason for the decrease related to:

- We continue to experience customer attrition particularly with our 10-10-XXX customer base which we have not marketed directly since 2002.
- We have also seen the average revenue per user ("ARPU") decline. We attribute this to increased cellular penetration and deregulation in various countries which have lower rates per month in those markets. This was most evident in India in 2004.
- In the first quarter of 2004, the Company commenced its efforts to attract local dial tone customers under the UNE-P platform, which are expected to be longer term and higher revenue generating than 1+ customers. At the end of the current quarter, the Company was offering such service in five states, New Jersey, New York, Massachusetts, Pennsylvania and Florida.
- See supplemental, statistical and financial data disclosed herein.

Technology licensing and related services revenue was $90 in the second quarter of 2004 as compared to $1,050 in the second quarter of 2003.

Operating costs and expenses

Telecommunications network expense was $15,680 in the three months ended June 30, 2004 as compared to $19,154 during the same period in 2003 (excluding costs associated with our network service offering of ($203) and $2,165, respectively).

Telecommunications services margins (telecommunications services revenues less telecommunications network expenses) continue to fluctuate significantly from period to period, and are expected to continue to fluctuate significantly for the foreseeable future. Predicting whether margins will increase or decline is difficult to estimate with certainty. Factors that have affected and continue to affect margins include:

- Differences in attributes associated with the various long-distance programs in place at the Company. The effectiveness of each offering can change margins significantly from period to period. Some factors that affect the effectiveness of any program include the ongoing deregulation of phone services in various countries where customer traffic terminates, actions and reactions by competitors to market pricing, the trend toward bundled service offerings and the increasing level of wireline to cellular connections. In addition, changes in customer traffic patterns also increase and decrease our margins.

- Our frame relay network and voice network. Each network has a significant fixed cost element and a minor variable per minute cost of traffic carried element; significant fluctuations in the number of minutes carried from month to month can significantly affect the margin percentage from period to period.

- Changes in contribution rates to the USF and other regulatory changes associated with the fund. Such changes include increases and decreases in contribution rates, changes in the method of determining assessments, changes in the definition of assessable revenue, and the limitation that USF contributions collected from customers can no longer exceed contributions.

Our selling, general, administrative and other expense was $14,074 in the three months ended June 30, 2004 as compared to $14,617 during the same period of 2003. The reduction in operating costs is due to a reduction in sales commission related to lower revenue offset by an increase in legal fees associated with the Company's patent infringement strategy and the defense of the Company and its officers in a derivative lawsuit (more fully described in note 13 of the condensed unaudited financial statements).

The provision for doubtful accounts was $1,740 in the three months ended June 30, 2004 as compared to $1,131 for the same period of 2003. The provision for doubtful accounts as a percent of revenue, excluding revenue from our network service offering, was approximately 6.6% for the three months ended June 30, 2004, versus approximately 3.4% for the three months ended June 30, 2003. Management is taking steps to bring the bad debt provision more into line with historical averages by tightening the credit granting process.

The Company commenced a research and development program incurring costs of $106 in the second quarter of 2004. This program is expected to allow the Company to provide enhanced telecommunication services to its customer base in the near term. The Company did not carry out any research and development work in 2003.

Depreciation and amortization was $1,653 in the three months ended June 30, 2004 compared to $1,758 during the same period of 2003.

Other income (expense)

Interest expense totaled $2,487 in the second quarter of 2004, of which $1,708 is pursuant to related party debt, compared to the second quarter of 2003, when $2,309 of the interest expense of $3,394 was pursuant to related party debt. Included in the interest expense for the second quarter of 2004 is BCF of $667, compared to $1,186 for the same period in 2003. Third party interest is lower in the second quarter of 2004 compared to the same period in 2003, due to lower average outstanding balance on the asset based facility partially offset by an increase in interest expense on regulatory amounts owing.

Interest and other income was $812 for the second quarter of 2004 compared to $1 during the second quarter of 2003. The increase of $811 related to the gain on the sale of shares of BUI common stock during second quarter of 2004.

Discontinued Operations

In the second quarter of 2004, there was no gain or loss from discontinued operations recorded, compared to the $371 gain reported in second quarter of 2003 related to the sale of the ILC business.

Segment Profitability

For the quarter ended June 30, 2004, our Telecommunications segment realized an operating segment loss of $5,819, while our Technologies segment recorded an operating segment loss of $486. We anticipate that through revenue growth and continued control of expenses, both segments will report operating income in future quarters. The measures of operating segment loss discussed above exclude $1,911 of net expenses that are not allocated to a specific segment. These consist primarily of selling, general and administrative costs, as well as $2,490 of interest expense, net of an $812 gain on the sale of the balance of our holdings in BUI common stock.

Six-Month Period Ended June 30, 2004 Compared to Six-Month Period Ended June 30, 2003

In order to more fully understand the comparison of the results of continuing operations for the six months ended June 30, 2004 as compared to the same period in 2003, it is important to note the following significant changes in our operations that occurred:

- In July 2003, we completed the acquisition of Transpoint. The operations of Transpoint have been included in the statement of operations for the six months ended June 30, 2004. However, there were no such operations in the same period of 2003.

- In November 2002, we began to sell a network service offering obtained from a new supplier. The sale of that product ceased in late July 2003. Revenue from this offering is recognized using the unencumbered cash method. In the first half of 2004, $6,553 was recognized in income compared to $4,142 in the same quarter of 2003. Expenses associated with this offering were recorded when incurred. In the second quarter of 2004 the Company recorded a recovery of $203 in telecommunications network costs compared to incurring a cost of $8,370 during the same period in 2003. The cessation of this product offering does not qualify as discontinued operations under generally accepted accounting principles.

- In January 2004, the Company commenced offering local dial tone services via the UNE-P. By June 30, 2004 services were being offered in five states and the Company had approximately local 11,000 customers.

Revenues

Telecommunications services revenue decreased $7,631 to $54,589 in the six month period ended June 30, 2004 as compared to $62,220 in the same period during 2003 (excluding revenues from our network service offering). The primary reason for the decrease related to:

- We continue to experience customer attrition particularly with our 10-10-XXX customer base which we have not marketed directly since 2002.

- We have also seen the average revenue per user ("ARPU") decline. We attribute this to increased cellular penetration and deregulation in various countries which have lower rates per month in those markets. This was most evident in India in 2004.

- In the first quarter of 2004, the Company commenced its efforts to attract local dial tone customers under the UNE-P platform, which are expected to be longer term and higher revenue generating than 1+ customers. At the end of the current quarter, the Company was offering such service in five states, New Jersey, New York, Massachusetts, Pennsylvania and Florida.

- See supplemental, statistical and financial data disclosed herein.

Technology licensing and related services revenue was $540 in the first half of 2004 as compared to $1,050 in the same period of 2003. In the first six months of 2003, the Company recorded revenue from the AccessLine contract. The revenue in 2004 relates to a contract that was entered into with a Japanese company in the third quarter of 2003. Under the terms of the contract, we earned $540 based on the receipt of funds related to the delivery of product in 2003. The Company has no continuing obligation related to this contract. Technology licensing revenues are project-based and, as such, these revenues will vary from period to period based on timing and size of technology licensing projects and payments.

Operating costs and expenses

Telecommunications network expense was $32,315 in the six months ended June 30, 2004 as compared to $38,697 during the same period in 2003 (excluding costs associated with our network service offering of ($203) and $8,371, respectively).

Telecommunications services margins (telecommunications services revenues less telecommunications network expenses) continue to fluctuate significantly from period to period, and are expected to continue to fluctuate significantly for the foreseeable future. Predicting whether margins will increase or decline is difficult to estimate with certainty. Factors that have affected and continue to affect margins include:

- Differences in attributes associated with the various long-distance programs in place at the Company. The effectiveness of each offering can change margins significantly from period to period. Some factors that affect the effectiveness of any program include the ongoing deregulation of phone services in various countries where customer traffic terminates, actions and reactions by competitors to market pricing, the trend toward bundled service offerings and the increasing level of wireline to cellular connections. In addition, changes in customer traffic patterns also increase and decrease our margins.

- Our frame relay network and voice network. Each network has a significant fixed cost element and a minor variable per minute cost of traffic carried element; significant fluctuations in the number of minutes carried from month to month can significantly affect the margin percentage from period to period.

- Changes in contribution rates to the USF and other regulatory changes associated with the fund. Such changes include increases and decreases in contribution rates, changes in the method of determining assessments, changes in the definition of assessable revenue, and the limitation that USF contributions collected from customers can no longer exceed contributions.

Our selling, general, administrative and other expense was $28,834 in the six months ended June 30, 2004 as compared to $28,841 during the same period of 2003.

The Company commenced a research and development program incurring costs of $106 in the first half of 2004. This program is expected to allow the Company to provide enhanced telecommunication services to its customer base in the near term. The Company did not carry out any research and development work in 2003.

The provision for doubtful accounts was $2,967 in the six months ended June 30, 2004 as compared to $2,306 for the same period of 2003. The provision for doubtful accounts as a percent of revenue, excluding revenue from our network service offering, was approximately 5.4% for the six months ended June 30, 2004, versus approximately 3.6% for the six months ended June 30, 2003. Management is taking steps to bring the bad debt provision more into line with historical averages by tightening the credit granting process.

Depreciation and amortization was $3,357 in the six months ended June 30, 2004 compared to $3,584 during the same period of 2003.

Other income (expense)

Interest expense totaled $6,022 in the six months ended June 30, 2004, of which $4,397 is pursuant to related party debt, compared to the same period in 2003, when $4,113 of the interest expense of $6,309 was pursuant to related party debt. Included in the interest expense for the six months ended June 30, 2004 is BCF of $2,536, compared to $2,183 for the same period in 2003. Third party interest is lower in the first half of 2004 compared to the same period in 2003, due to lower average outstanding balance on the asset based facility partially offset by an increase in interest expense on regulatory amounts owing.

Interest and other income increased $2,186 to $2,189 for the six months ended June 30, 2004 from $3 during the same period of 2003. The increase is primarily due to a gain of $767 related to the discharge of certain obligations associated with our former participation with a consortium of owners in an indefeasible right of usage, and a gain of $1,376 from our sale of shares of BUI common stock in the first six months of 2004.

Discontinued Operations

In the first half of 2004, we recorded a gain from discontinued operations of $104 related to the sale of our ILC operations to BUI entered into in December 2002. The sale closed on May 1, 2003. Contingent shares (10,714) of BUI stock were earned during the three months ended March 31, 2004, with a value of $104. In the first half of 2003, we recorded a gain from discontinued operations of $94 related to the sale of the ILC business.

Segment Profitability

For the six months ended June 30, 2004, our Telecommunications segment realized an operating segment loss of $4,644, while our Technologies segment recorded an operating segment loss of $407. We anticipate that through revenue growth and continued control of expenses, both segments will report operating income in future quarters. The measures of operating segment income and loss discussed above exclude $4,476 of net income and expenses that are not allocated to a specific segment. These consist primarily of selling, general and administrative costs, as well as $5,872 of interest expense, net of a $1,376 gain on the sale of our holdings in BUI common stock and a gain of $767 recognized on the discharge of an obligation during the first quarter of 2004.

Item 3 – Quantitative and Qualitative Disclosures about Market Risk.

Our exposure to market risk is limited to interest rate sensitivity, which is affected by changes in the general level of United States interest rates. Our cash equivalents are invested with high quality issuers and we limit the amount of credit exposure to any one issuer. Due to the short-term nature of the cash equivalents, we believe that we are not subject to any material interest rate risk as it relates to interest income. As to interest expense, we have one debt instrument that has variable interest rates based on the prime rate of interest. Assuming the debt amount on our asset backed facility at June 30, 2004 were constant during the next twelve-month period, the impact of a one percent increase in the prime interest rate would be an increase in interest expense of approximately $72 for the next twelve-month period. However, because the debt instrument is subject to an interest rate floor of 6.0%, a one percent decrease in the prime interest rate would have no impact on interest expense during the next twelve-month period. We do not believe that we are subject to material market risk on our fixed rate debt with Counsel in the near term.

We did not have any foreign currency hedges or other derivative financial instruments as of June 30, 2004. We do not enter into financial instruments for trading or speculative purposes and do not currently utilize derivative financial instruments. Our operations are conducted primarily in the United States and as such are not subject to material foreign currency exchange rate risk.

Item 4 – Controls and Procedures.

As of the end of the period covered by this quarterly report, the Company carried out, under the supervision of and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer (the "Certifying Officers"), an evaluation of the effectiveness of its "disclosure controls and procedures" (as the term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based on this evaluation, the Certifying Officers have concluded that the Company's disclosure controls and procedures were not effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Exchange Act, and the rules and regulations promulgated thereunder. This deficiency constitutes a material weakness, and detailed below are the facts surrounding this matter.

On September 20, 2004, management of the Company concluded that the requirements of Emerging Issues Task Force Issue No. 00-27 ("EITF 00-27"), regarding the accounting for Beneficial Conversion Features ("BCF") present on convertible debt and preferred stock instruments had not been properly applied in current and prior years to its convertible debentures issued in March 2001. While the initial accounting for the BCF at the time of the issuance of the debentures was correct, the Company failed to remeasure the BCF as required by EITF 00-27 when at subsequent dates the number of shares and effective conversion prices changes as the result of the debentures' anti-dilution provisions. These anti-dilution events and their respective impacts on the number of shares and the conversion price were disclosed in the Company's previous public filings. However, under EITF 00-27 the BCF should also have been remeasured at the date of each anti-dilution event. Additionally, the debentures called for the addition of accruing interest to the debentures, as a result of which such accruing interest is deemed to have been paid in kind ("PIK") and the Company failed, as required by EITF 00-27, to measure the BCF upon the deemed interest of the PIK convertible debentures.

This matter was raised by the Company's recently appointed independent auditors, BDO Seidman, LLP ("BDO"), in the course of their review of the Company's prior public filings. After discussions among the Company's management, BDO, and the Company's prior auditors, PricewaterhouseCoopers, LLP ("PwC"), the Company's management concluded that a correction of the prior accounting on this matter was required. The Company's management brought the matter for consideration before the Audit Committee and the full Board of Directors of the Company. Having considered the circumstances underlying the accounting errors and their effects upon the Company's prior filings, and having discussed the matter with the BDO and PwC representatives as well as the Company's management, the Audit Committee concluded that the previously issued financial statements should not be relied upon and approved and authorized the Company's management to amend certain previously filed public reports.

Additionally, management and the Audit Committee considered what changes, if any, were necessary to the Company's disclosure controls and procedures to ensure that the errors described above would not reoccur and to provide that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Exchange Act, and the rules and regulations promulgated thereunder. In its review the Audit Committee noted that the errors described above (i) related principally to periods that preceded changes the Company has already made to consolidate and upgrade its accounting staff and function, and (ii) that the errors described above did not result from the failure of the Company's disclosure controls and procedures to make known to the appropriate officials and auditors the facts concerning the Company's convertible debentures or the occurrence of the anti-dilution events. As a result management and the Audit Committee determined that education and professional development of accounting staff on the complications of EITF 00-27 and its application would be sufficient to prevent a reoccurrence. This knowledge development has occurred as of September 2004. No additional changes to the Company's disclosure controls and procedures were needed in response to the discovery of the errors described above.

Further, there were no changes in the Company's internal control over financial reporting during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings

On April 16, 2004, certain shareholders of the Company (the "Plaintiffs") filed a putative derivative complaint in the Superior Court of the State of California in and for the County of San Diego, (the "Complaint") against the Company, WorldxChange Corporation (sic), Counsel Communications LLC, and Counsel Corporation as well as certain present and former officers and directors of the Company, some of whom also are or were directors and/or officers of the other corporate defendants (collectively, the "Defendants"). The Complaint alleges, inter alia, that the Defendants, in their respective roles as controlling shareholder and directors and officers of the Company committed breaches of the fiduciary duties of care, loyalty and good faith and were unjustly enriched, and that the individual Defendants committed waste of corporate assets, abuse of control and gross mismanagement. The Plaintiffs seek compensatory damages, restitution, disgorgement of allegedly unlawful profits, benefits and other compensation, attorneys' fees and expenses in connection with the Complaint. The Company believes that these claims in their entirety are without merit and intends to vigorously defend this action. There is no assurance that this matter will be resolved in the Company's favor and an unfavorable outcome of this matter could have a material adverse impact on its business, results of operations, financial position or liquidity.

Acceris and several of Acceris' current and former executives and board members were named in a securities action filed in the Superior Court of the State of California in and for the County of San Diego on April 16, 2004, in which the plaintiffs made claims nearly identical to those set forth in the derivative suit above. The Company believes that these claims in their entirety are without merit and intends to vigorously defend this action. There is no assurance that this matter will be resolved in the Company's favor and an unfavorable outcome of this matter could have a material adverse impact on its business, results of operations, financial position or liquidity.

In connection with the Company's efforts to enforce its patent rights, Acceris Communications Technologies Inc. filed a patent infringement lawsuit against ITXC Corp. ("ITXC") in the United States District Court of the District of New Jersey on April 14, 2004. The complaint alleges that ITXC's VoIP services and systems infringe the Company's U.S. Patent No. 6,243,373, entitled "Method and Apparatus for Implementing a Computer Network/Internet Telephone System." On May 7, 2004, ITXC filed a lawsuit against Acceris Communications Technologies Inc., and the Company, in the United States District Court for the District of New Jersey for infringement of five ITXC patents relating to VoIP technology, directed generally to the transmission of telephone calls over the Internet and the completion of telephone calls by switching them off the Internet and onto a public switched telephone network. The Company believes that the allegations contained in ITXC's complaint are, in their entirety, without merit and the Company intends to provide a vigorous defense to ITXC's claims. There is no assurance that this matter will be resolved in the Company's favor and an unfavorable outcome of this matter could have a material adverse impact on its business, results of operations, financial position or liquidity.

At our Adjourned Meeting of Stockholders held on December 30, 2003, our stockholders approved an amendment to our Articles of Incorporation, deleting Article VI thereof (regarding liquidations, reorganizations, mergers and the like). Stockholders who were entitled to vote at the meeting and advised us in writing, prior to the vote on the amendment, that they dissented and intended to demand payment for their shares if the amendment was effectuated, were entitled to exercise their appraisal rights and obtain payment in cash for their shares under Sections 607.1301 – 607.1333 of the Florida Business Corporation Act, provided their shares were not voted in favor of the amendment. In January 2004, appraisal notices in compliance with Florida corporate statutes were sent to all stockholders who had advised us of their intention to exercise their appraisal rights. The appraisal notices included our estimate of fair value of our shares, being $4.00 per share on a post-split basis. These stockholders had until February 29, 2004 to return their completed appraisal notices along with certificates for the shares for which they were exercising their appraisal rights. Approximately 33 stockholders holding approximately 74,000 shares of our stock returned completed appraisal notices by February 29, 2004. A stockholder of 20 shares notified us of his acceptance of our offer of $4.00 per share, while the stockholders of the remaining shares did not accept our offer. Subject to the qualification that we may not make any payment to a stockholder seeking appraisal rights if, at the time of payment, our total assets are less than our total liabilities, stockholders who accepted our offer to purchase their shares at the estimated fair value will be paid for their shares within 90 days of our receipt of a duly executed appraisal notice. If we should be required to make any payments to dissenting stockholders, Counsel will fund any such amounts through the purchase of shares of our common stock. Stockholders who did not accept our offer were required to indicate their own estimate of fair value. Because Acceris did not agree with the estimates submitted by many of the dissenting shareholders, Acceris has sought a judicial determination of the fair value of the common stock held by the dissenting stockholders. On June 24, 2004, Acceris filed suit against the dissenting shareholders seeking a declaratory judgment, appraisal and other relief in the Circuit Court for the 17th Judicial District in Broward County, Florida. There is no assurance that this matter will be resolved in the Company's favor and an unfavorable outcome of this matter could have a material adverse impact on our business, results of operations, financial position or liquidity.

The Company is involved in various other legal matters arising out of its operations in the normal course of business, none of which are expected, individually or in the aggregate, to have a material adverse effect on the Company.

Item 2 – Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.

During the three months and six months ending June 30, 2004, approximately 73,100 and 142,100 options, respectively, were issued to employees under the 2003 Employee Stock Option and Appreciation Rights Plan. These options are issued with exercise prices that equal or exceed fair value on the date of the grant and vest over a 4-year period subject to the grantee's continued employment with the Company. The Company relied on an exemption from registration under Section 4 (2) of the Securities Act of 1933.

Additionally, during the three months and six months ended June 30, 2004, approximately 175,000 and 600,000 warrants, respectively, have been issued under the Acceris Communications Inc. Platinum Agent Program at an exercise price of $3.50 per share. See Note 13 to the condensed consolidated financial statements included in Part I herein for a description of the vesting provisions of these warrants. The Company relied on an exemption from registration under Regulation D under the Securities Act of 1933.

The Company did not acquire any stock of the Company in the three and six months ended June 30, 2004.

Item 3 – Defaults Upon Senior Securities.

None.

Item 4 – Submission of Matters to a Vote of Security Holders.

None.

Item 5 – Other Information.

None.

Item 6 – Exhibits and Report on Form 8-K.

(a) Exhibits

3.1 Amended and Restated Articles of Incorporation (1)

3.2 Bylaws, as amended (2)

31.1 Certification pursuant to Rule 13a-14(a) and 15d-14(a) required under Section 302 of the Sarbanes-Oxley Act of 2002 (3)

31.2 Certification pursuant to Rule 13a-14(a) and 15d-14(a) required under Section 302 of the Sarbanes-Oxley Act of 2002 (3)

32.1 Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (3)

32.2 Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (3)

(1) Incorporated by reference to our quarterly report on Form 10-QSB for the quarter ended June 30, 1996, file number 000-17973.

(2) Incorporated by reference to our quarterly report on Form 10-Q for the quarter ended September 30, 1998, file number

000-17973.

(3) Filed herewith.

(b) – Report on Form 8-K

(i) On May 11, 2004, the Company filed a Current Report on Form 8-K, under Items 4 and 7.

(ii) On May 14, 2004, the Company filed a Current Report on Form 8-K, under Item 12.

(iii) On May 19, 2004, the Company filed a Current Report on Form 8-K, under Item 4.

(iv) On May 25, 2004, the Company filed a Current Report on Form 8-K, under Item 5.

(v) On July 19, 2004, the Company filed a Current Report on Form 8-K, under Item 5.

(vi) On August 11, 2004, the Company filed a Current Report on Form 8-K, under Item 5.

(vii) On September 29, 2004, the Company filed a Current Report on Form 8-K, under Item 404 and 901.

No financial statements were filed in connection with any of the foregoing Current Reports on Form 8-K.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunder duly authorized.

Acceris Communications Inc.

(Registrant)

Date: September 30, 2004

By: /s/ Allan C. Silber

Allan C. Silber
Chairman of the Board of Directors and
Chief Executive Officer

By: /s/ Gary M. Clifford

Gary M. Clifford
Chief Financial Officer and Vice President of Finance